**THE COMMONWEALTH OF MASSACHUSETTS**
**DEPARTMENT OF PUBLIC UTILITIES**

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D.P.U. No. 97-96

Investigation by the Department of Public Utilities Upon Its Own Motion Commencing a Rulemaking, Revising Standards of Conduct Governing the Relationship Between Gas and Electric Distribution Companies and Their Unregulated Marketing Affiliates

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## COMMENTS OF CABLEVISION SYSTEMS CORPORATION

Cablevision Systems Corporation ("Cablevision") submits these comments in response to the notice of proposed rulemaking by the Department of Public Utilities (the "Department") in this docket. Cablevision addresses both the Department's proposed extension of its existing Standards of Conduct at 220 C.M.R. § 12.00 to all relationships between electric and gas distribution companies and their unregulated affiliates, and the Department's request for other proposed revisions to the Standards of Conduct appropriate to protect ratepayers from improper cross-subsidization of unregulated affiliates.

Cablevision, through its subsidiaries and affiliates Cablevision of Boston, Inc., Cablevision of Framingham Holdings, Inc. and A-R Cable Partners, owns and operates cable television systems in 39 cities and towns in Massachusetts. Another Cablevision subsidiary, Cablevision Lightpath-MA, Inc., has been certified by the Department as a telecommunications common carrier and plans to provide competitive telephone service in the Boston area. One of the goals of the Telecommunications Act of 1996 was to open the door to facilities-based competition in local exchange markets – a goal that

remains elusive. Nascent competition in telecommunications needs the Department's protection no less than that in energy services.

In *Standards of Conduct*, D.P.U. 96-44 (Dec. 30, 1996), the Department acknowledged the need to protect competitive energy markets from subsidization by the ratepayers of regulated distribution companies. Since the issuance of D.P.U. 96-44, as the Department's proposed rules recognize, there is an increasing convergence of the electric, gas, and telecommunications industries as the restructuring of monopoly industries traditionally regulated by rate of return regulation removes long-standing boundaries of competition and opens the way for entry by gas and electric companies into new markets.

The Department's proposal to extend its Standards of Conduct for affiliated transactions to gas and electric utility affiliates engaged in non-energy businesses recognizes the risk that electric utilities will subsidize their unregulated non-energy business ventures unfairly. Incentives to cross-subsidize other business ventures to gain an advantage in competitive markets exist regardless of whether the other business ventures are energy-related. Thus, Cablevision believes that adoption of the Department's proposed rules is necessary to protect ratepayers and competition. Cablevision also respectfully submits that additional measures are needed to reinforce protection both of ratepayers and of competition.

### 1. The Provisions of 220 C.M.R. §§ 12.00 et seq. Should Be Extended to Affiliates Engaged in Non-Energy-Related Businesses.

Cablevision believes that the need to extend the Standards of Conduct to affiliates engaged in non-energy-related businesses has become immediate. As the Department recognizes in its notice,

Massachusetts in recent years has seen increasing convergence of the electric and natural gas industries with non-energy-related industries such as cable television and telecommunications. Both Boston Edison Company and The New England Electric System have made visible and significant investments in communications. Testimony submitted by Boston Edison Company in another proceeding before the Department attests to the wide variety of markets in which electric utilities are pursuing opportunities, both energy-related and not, which are "the direct product of the unbundling process inherent in electric restructuring." Direct Testimony of John J. Reed at 5-6, D.P.U. 97-63 (filed Sept. 12, 1997).[1] Such activities, in turn, have given rise to increasing concerns about cross-subsidization and other inappropriate use of electric and gas company assets and resources that have been developed under rate of return or price cap regulation on behalf of affiliated companies in non-energy-related businesses. The Department has long recognized that a traditionally-regulated monopoly has incentives to cross-subsidize a competitive affiliate, distorting the market in which the affiliate competes. As the Department observed in *IntraLATA Competition*, D.P.U. 1731 at 28 (1985):

> Regulated firms have incentives to shift costs to those more monopolistic services and to attempt to use revenues from those markets to cross-subsidize more competitive service offerings. As competition in a market increases, prices in a market become driven more by market forces. For these market forces to operate properly, however, firms must not be in a position to manipulate markets through the use of predatory pricing practices.

*See also Boston Edison Company*, D.P.U. 850 (Feb. 9, 1983); *New England Telephone & Telegraph Co.*, D.P.U. 94-50-C, at 6 (June 28, 1995) (price floor required in price cap plan "to prevent . . . anticompetitive pricing" in addition to cross-subsidization); *New England Telephone & Telegraph Co.*, D.P.U. 86-33-C, at 74 (July 31, 1987) ("in a competitive market,

[1] Because of its extensive discussion of competitive ventures by electric utilities, Cablevision is attaching a copy of Mr. Reed's testimony for the Department's convenience in this proceeding.

. . . the Department's need to measure cross-subsidization becomes even more critical"); *New England Telephone & Telegraph Co.*, D.P.U. 86-17, at 15 (July 29, 1986) ("A transfer at less than market value . . . may undermine the competitiveness of the market for radio utility services").

Consistent with this understanding of economic forces, in embarking on restructuring the electric utility industry, the Department recognized that "appropriate safeguards against cost-shifting and cross-subsidization" are necessary. *Electric Industry Restructuring*, D.P.U. 95-30, at 39 (Aug. 16, 1995). As the Department stated:

> [W]e remain sensitive to the possibility that regulated electric companies may engage in market power abuse, or exact subsidies from ratepayers to fund the activities of a competitive division, by affording their affiliates preferential access to information, tying the purchase of one product to the purchase of another, or through other anticompetitive conduct.

*Model Rules & Legislative Proposal*, D.P.U. 96-100 (Dec. 30, 1996). The risk of such abuses exists whether the utilities' affiliates are engaged in energy-related businesses or not. In *Standards of Conduct*, the Department noted that "cross-subsidization issues exist regardless of the type of competitive activity engaged in by the affiliate." D.P.U. 96-44 at 7 n.5.

In the telecommunications field, Cablevision is deeply concerned about electric and gas distribution companies engaging in unfair cross-subsidization by transferring use of their infrastructure, employees, customer lists, databases, goodwill, and other assets, all acquired in a traditionally regulated environment, on a preferential basis to affiliated companies. Cablevision has had to purchase, construct, and develop essential elements of its cable systems. If a gas or electric utility affiliate in competition with Cablevision receives elements of its system at less than full market value or preferential terms, it enables the affiliate to offer subscribers prices that do not reflect the real costs of the services

offered. This distorts the marketplace and gives the affiliate a competitive advantage over Cablevision. This advantage is gained at the expense of the distribution company's ratepayers under regulation, who are saddled with the cost of subsidizing the company's entry into a non-energy-related market, without any commensurate benefit to their rates.

The Department has recognized the inevitable need to address appropriate standards for distribution companies' dealings with any of their competitive affiliates. Indeed, the Department's recognition of the need to address these issues has given birth to this proceeding. With Boston Edison's proposed reorganization plan, the Department is faced with issues of the impact of Boston Edison Company's corporate reorganization on ratepayers and the need for "appropriate safeguards to insure that ratepayers do not subsidize unregulated activities." *Interlocutory Order on The Scope of the Proceeding and Petitions for Leave to Intervene* at 13, D.P.U. 97-63 (Sept. 2, 1997). And the Department has commenced an investigation to consider, *inter alia*, Boston Edison's relationship with its affiliates and the impact, if any, of these relationships on competition in the telecommunications and cable industries. *See Order Opening an Investigation*, D.P.U. 97-95 (Oct. 10, 1997).

Unless the Department extends its Standards of Conduct, it faces recurring issues and proceedings like those involving Boston Edison. Thus, there is a pressing need for extension of the standards of conduct to all affiliates of electric and gas distribution companies, "regardless of the type of business engaged in by the affiliate," to prevent inappropriate use of ratepayer funds or assets to subsidize anticompetitive business activity in non-energy-related markets, whether directly through the transfers of assets or indirectly through preferential access to their facilities, services, and customers.

### 2. The Department Has Authority Pursuant to G.L. c. 164, §§ 76A And 85, as Well as Other Provisions, to Extend The Standards of Conduct to Affiliated Companies Engaged in Non-Energy-Related Businesses.

As the Department noted in *Standards of Conduct*, "application of the Standards of Conduct to non-energy related activities would be a valid exercise of the Department's jurisdiction." D.P.U. 96-44 at 7 n.5 Although the notice of proposed rulemaking in this proceeding focuses on M.G.L. c. 164, §§ 76A and 85, the Department found "ample authority to review and prescribe a distribution company's relationship with its affiliate" not only in these sections but also in sections 76C, 85A, 94A, 94B, and 94C. *Id.*

M.G.L. c. 164, § 85, which defines the term "affiliated company," makes no distinction between affiliates involved in the energy industry and those involved in other activities. Section 85 further authorizes the Department to examine the records, contracts, or physical property of "any company subject to this chapter, and of any affiliated company with respect to **any** relations, transactions or dealing, direct or indirect, between such affiliated company and any company so subject" (emphasis supplied), without regard to whether the affiliate is engaging in energy-related or non-energy-related business.

Likewise, Section 76A (emphasis supplied) states that the Department:

> shall have the **general supervision** of every affiliated company . . . with respect to all relations, transactions and dealings, direct or indirect, with the gas or electric company with which it is affiliated, which affect the operations of such gas or electric company, and shall make all necessary examination and inquiries and keep itself informed as to such relations, transactions and dealings as have a bearing upon the price of gas or electricity supplied by such company . . . . Such relations, transactions and dealings . . . shall be subject to review and investigation by the department . . . .

Nothing in the statute states – or even implies – that the affiliate must be engaging in energy-related activities in order for the relationship between the affiliate and the gas or electric company to be subject to Department scrutiny and regulation.

Moreover, the Department's authority over affiliate transactions does not rest solely on Sections 76A and 85. Section 76 confers on the Department direct supervisory authority over gas and electric corporations "and the manner in which they are conducted." Section 76C is a "broad grant of authority" that provides the Department with rulemaking authority to "carr[y] out the scheme and design" of Chapter 164 even if not based on any particular section. *Cambridge Electric Light Co. v. DPU*, 363 Mass. 474, 494 (1973). Sections 94B and 94C further reinforce the Department's authority over affiliate transactions by requiring Department approval of certain contracts providing compensation to affiliates, and placing on the utility the burden to justify the "reasonableness" of affiliate transactions called into question.

As the Department stated in *Standards of Conduct*, its powers are broadest where they affect ratemaking. D.P.U. 96-44 at 7 n. 5. For example, in *Commonwealth Electric Co.*, D.P.U. 88-135/151 (Oct. 28, 1988), a rate investigation, the Department held that it had jurisdiction to inquire into Commonwealth Electric's dealings with its wholly-owned realty trust and two real estate partnerships in which the trust held an interest, notwithstanding the fact that these entities were not involved in energy-related fields. Section 85 complements the Department's rate authority by giving it the tools to inquire fully into affiliate transactions.

The Standards of Conduct are directly related to the Department's ratemaking authority. They establish a set of mechanisms that facilitate proper cost allocation between affiliates and the regulated

utility.[2] Several of the Standards of Conduct address the issue of allocation.[3] Other provisions that address nondiscrimination between affiliates and unaffiliated companies also work to insure appropriate allocation by creating a mechanism for pricing of goods and services provided to affiliates at market rates.[4]

The Department's authority to regulate affiliate transactions is part of a statutory scheme to protect ratepayers and protect against monopoly abuses by utility companies. *See, e.g., Boston Edison Co. v. DPU*, 375 Mass. 1, 44 (1978)("It has long been held that 'the state, through the regularly constituted authorities, has taken complete control of [electric utilities] so far as is necessary to prevent the abuses of monopoly"). Thus, the extension of the Standards of Conduct to protect ratepayers and guard against monopoly abuses by utilities in non-energy-related markets is entirely consistent with the Department's statutory authority.

3. **The Department Has Authority to Regulate Any Other Transactions And Dealings between Electric And Gas Distribution Companies And Their Affiliates Engaged in Non-Energy-Related Businesses.**

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[2] Reliance on cost accounting alone would be uncertain and inevitably arbitrary. *See, e.g., Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 34 (1st Cir. 1990) ("Accounting systems for allocating investment between different services or customer classes are notoriously complicated and sometimes arbitrary"), *cert. denied*, 499 U.S. 931 (1991).

[3] *See* 220 C.M.R. 12.03(13) ("The Distribution Company shall fully and transparently allocate costs for any shared facilities or general and administrative support services provided to the Competitive Affiliate"); 12.03(14) ("A Distribution Company and its Competitive Affiliate shall keep separate books of accounts and records . . .).

[4] *Id.*, 12.03(4) ("If a Distribution Company provides its Competitive Affiliate, or customer of its Competitive Affiliate, any product or service other than general administrative support services, it shall make the same products or services available to all Non-affiliated Suppliers or customers on a non-discriminatory basis."); 12.03(6) ("If a Distribution Company offers its Competitive Affiliate, or a customer of its Competitive Affiliate, a discount, rebate or fee waiver for any product or service, it shall make the same available on a non-discriminatory basis to all Non-affiliated Suppliers or customers").

The existing Standards of Conduct do not represent the full arsenal of measures the Department can take to protect ratepayers or supervise the behavior of electric utilities. For the reasons discussed above, the Department has "ample authority" to adopt measures necessary to carry out the statute's purposes of protecting ratepayers and guarding against monopoly abuses. The Department may adopt additional measures to carry out these purposes.

4. **The Application of 220 C.M.R. §§ 12.00 <u>et seq.</u> Should Not Make A Distinction between Affiliated Companies That Are in Other Industries Subject To Regulation by The Department or Another State Agency And Affiliated Companies in Unregulated Industries.**

Although Cablevision competes in industries regulated by the Department, Cablevision submits that the standards of conduct should not make any distinction between affiliated companies in regulated industries and those in unregulated industries. Many regulated industries also are competitive. For example, insurance, banking, and health care, as well as telecommunications and video programming, all are regulated yet highly competitive businesses. By the same token, some unregulated businesses – newspaper publishing, for example – are not very competitive.

When a gas or electric distribution company cross-subsidizes a competitive affiliate, the market in which the affiliate competes becomes distorted, whether or not the market at issue is subject to government regulation. Such cross-subsidization is unfair to ratepayers in the regulated market regardless of the regulatory status of the industry targeted. Consequently, Cablevision submits that **any** cross-subsidization of competitive affiliates by gas and electric distribution companies should be barred altogether.

5. **Transactions And Dealings between An Electric Or Gas Distribution Company And An Affiliated Company Engaged in A Non-Energy Related Business Can Affect The Competitiveness of The Relevant Non-Energy-Related Market Whenever Cross-Subsidization Occurs.**

Competition in non-energy services, such as local exchange telecommunications, is especially vulnerable to cross-subsidization and monopoly leveraging. However, application of the Standards of Conduct should not depend on a market-by-market analysis of the vulnerability or robustness of competition. Rather, the Department must protect ratepayers from subsidizing any competitive ventures. Cross-subsidization is unfair to ratepayers regardless of the level of competition in the market being subsidized.

Moreover, any cross-subsidization by an electric or gas distribution company of its competitive affiliate's non-energy related business affects the ability of other unsubsidized, competitors to compete with the affiliate. This, in turn, distorts the relevant non-energy-related market. The anticompetitive effects of such cross-subsidization manifest themselves in such activities as the transfer of assets to the affiliate below full market value, and the improper investment in or transfer of funds by the distribution company to the affiliate, thereby enabling the affiliate to engage in predatory pricing practices. While the degree of distortion may vary from market to market, any such distortion is antithetical to the public interest.

For the Department to attempt to measure the level of competition in different non-energy markets, and thereby carve out different standards for different transactions or circumstances, is simply unworkable. The Department's Standards of Conduct should extend unequivocally to all transactions and dealings between electric and gas distribution companies and their non-energy-related competitive affiliates.

## 6. Additional Standards of Conduct Would Prevent Improper Cross-Subsidization by Gas Or Electric Distribution Companies of Affiliated Companies, Regardless of The Field in Which The Affiliated Company Does Business.

Cablevision respectfully submits that the present Standards of Conduct (extended to non-energy affiliates) should be enhanced as set forth below.

### A. Disclosure And Audit of Transactions.

Cablevision proposes that the Standards of Conduct require that all relations, transactions or dealings, direct or indirect, between gas and electric utilities and their affiliates must be reduced to writing and made available for public inspection, disclosing the dates, the nature, the book and market value, and the accounting entries related to such relations, transactions or dealings. Such disclosure would serve the same function as individual case basis tariffs and as 220 C.M.R. 12.03 (5), placing on notice the Department as well as others who might wish to obtain the same terms.[5]

Tracking 220 C.M.R. 12.03 (5) and applying that posting requirement to the sale of goods, services, or facilities, Cablevision proposes the following language:

> A Distribution Company shall not offer or sell to any Affiliated Company, or customer of its Affiliated Company, any product, service or facility, or any discount, rebate or fee waiver for any product, service, or facility without simultaneously posting the offering electronically on a source generally available to the market or filing the offering with the Department, stating the date of offering , the book and market value of the product or service offered, and specifying the applicable accounts affected.

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[5] The experience of Boston Edison's joint agreement with RCN Telecom Services of Massachusetts, Inc. illustrates the need for full disclosure of such relationships: once the details of this transactions became known through RCN's filing of a registration statement with the Securities Exchange Commission, the Department found sufficient basis to open an investigation on its own motion into, among other things, the nature and extent of Boston Edison's investment. *See Order Opening an Investigation*, D.P.U. 97-95 (Oct. 10, 1997).

Alternatively or additionally, the Department could adopt an annual audit requirement, as required for competitive affiliates of Bell Operating Companies in Section 272 (c) of the Telecommunications Act of 1996, as follows:

> A Distribution Company operating an Affiliated Company shall obtain and pay for an annual audit to determine whether the Distribution Company has complied with these Standards of Conduct, and particularly whether such company has complied with the separate accounting requirements under 220 C.M.R. 12.03 (13) and (14). Such auditor shall have access to the financial accounts and records of the Distribution Company and any of its Affiliated Companies necessary to verify the transactions conducted and compliance with these Standards of Conduct. The results of such audit shall be submitted to the Department and shall be public records.

**B. Include "Facilities" in Covered Transactions.**

As reflected in the language above, Cablevision submits that 220 C.M.R. 12.03 (4) through (7) need to be applicable explicitly to "facilities" as well as to "products" or "services." As the Department observed at the time that it adopted the existing Standards of Conduct, "electric companies will enter a restructured, competitive electric industry with certain advantages: substantial physical assets including plant equipment, and sites acquired over a monopoly period, and largely financed by ratepayers; …." D.P.U. 96-100 at 237 (Dec. 30, 1996). For example, Boston Edison's transaction with the RCN-BETG joint venture involves the transfer from the regulated utility to its affiliate of fiber optic facilities, rights of way, conduit, transmission space and other facilities. Regulated distribution companies should not be able to use their extensive networks of facilities to benefit competitive ventures, whether or not energy-related, without ratepayers receiving commensurate benefit. Given the Department's prior recognition of the value of such assets, the omission of "facilities" appears unintended.[6]

**C. Pricing of Asset Transfers**

[6] The Department has rejected the argument "that the term 'products and services' … should be qualified." D.P.U. 96-44 at 9.

Cablevision submits that the transfer of any assets from the regulated utility to the affiliate must be made at the higher of net book or fair market value. This is consistent with restructuring legislation. *See* An Act Relative to Restructuring The Electric Utility Industry § 189 (Conference Committee Bill).[7] Such transfer pricing will insure that ratepayers are compensated fairly and are not deprived of value created by virtue of a distribution company's public utility status.

Cablevision proposes that the following language be included in the Standards of Conduct:

> A Distribution Company shall not transfer to an Affiliated Company, whether by sale or otherwise, any product, service, facility, or other tangible or intangible asset without receiving consideration at the higher of fair market value or the Distribution Company's net book value. In the event of the transfer of any exclusive or unique product, service, facility, or tangible or intangible asset, such transfer shall be by public auction.

**D. Separate Officers And Directors.**

Cablevision proposes that the Department extend its requirement of separate employees to prohibit overlapping officers and directors between regulated utilities and affiliates by amending 220 C.M.R. 12.03 (13) to add "Officers, directors, and …" at the beginning of the section. Otherwise, officers and directors of both the regulated utility and its affiliate will owe overlapping fiduciary duties that create inevitable conflicts of interest and invite self-dealing. Companies with overlapping officers and directors cannot be expected to act the same toward each other as they would toward unaffiliated companies. Extension of 220 C.M.R. 12.03(13) to officers and directors would make separate corporations truly separate and follow the separations requirement adopted by Congress in Section 272 (b)(3) of the Telecommunications Act of 1996.

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[7] In D.P.U. 97-63, Boston Edison Company has offered such asset transfer pricing as an "appropriate" safeguard for affiliate transactions. Testimony of Douglas S. Horan at 13, D.P.U. 97-63 (filed Sept. 12, 1997).

7. **Application of Standards of Conduct to An Affiliated Company Engaged in A Non-Energy Related Business Will Not Impede The Affiliated Company's Ability to Compete on An Equal Footing in Its Own Market.**

Compliance with the Department's Standards of Conduct with respect to non-energy related business would not place the affiliated company at a competitive disadvantage in its own market. To the contrary, such application would simply require that affiliated companies conduct their business with regulated utilities at arm's length – just as other competitors do. Requiring that utilities and their affiliates compete on a level playing field will hardly impede their ability to compete.

8. The Standards of Conduct Should Not Permit The Release Of Proprietary Customer Information with Other Than Prior Written Authorization of The Customer.

Electric utilities have proprietary information on all customers in their service areas by virtue their traditional monopoly utility status. Customers have legitimate privacy interests in such information. Prohibiting the release of proprietary customer information by an electric or gas distribution company, absent the prior written authorization of the customer, is crucial to a competitive market, whether that market is energy related or non-energy related. The Department has expressed concern that "affording affiliates preferential access to information" can injure competition. D.P.U. 96-100 at 237. Indeed, Cablevision itself is barred by federal law from releasing personally identifiable customer information without authorization. *See* 47 U.S.C. §631.

To illustrate this point, if Cablevision wished to obtain customer information regarding its target market, it would have to do so by approaching potential customers directly. By contrast, a electric or gas distribution company's affiliate in the video or telecommunications field would, in the absence of a

bar on information sharing without customer authorization, be able to receive – and divulge[8] – such information from its parent, thereby giving it a substantial and unfair advantage over Cablevision.

The restrictions on information sharing contained in Rule 12.03(9) advance the Department's goal of encouraging fair and open competition in the marketplace. Should the Department conclude that it will permit the release of proprietary customer information under certain circumstances without the customer's prior written authorization, however, Cablevision urges that the Standards of Conduct require that such information be available on equal terms to all similarly situated non-affiliated companies in a nondiscriminatory manner. Such a requirement would help to ensure a marketplace where affiliated and non-affiliated companies can compete on an equal footing.

**Conclusion**

This proceeding affords an important opportunity to protect ratepayers and insure that the restructuring of the traditionally regulated electric industry now developing affords fair competition in all affected markets. The Department can do so by adopting its proposed regulations and the additional safeguards proposed above.

[8] A cable television competitor would be subject to 47 U.S.C., §631. On the other hand RCN, as an Open Video System operator, and other multichannel programming providers are not.

Respectfully submitted,

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